



ENVIRONMENTAL QUALITY COUNCIL

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ENVIRONMENTAL QUALITY COUNCIL ENERGY POLICY SUBCOMMITTEE MINUTES

Date approved: *

September 13, 2004

Room 102, State Capitol Building

Please Note: These are summary minutes. Testimony and discussion are paraphrased and condensed. Committee exhibits are on file in the offices of the Legislative Services Division.

COMMITTEE MEMBERS PRESENT

SEN. DANIEL MCGEE, CHAIR
SEN. WALTER MCNUTT
SEN. GLENN ROUSH
SEN. KEN TOOLE
REP. NORMA BIXBY
MR. TOM EBZERY

STAFF PRESENT

TODD EVERTS, Legislative Environmental Analyst

AGENDA & VISITORS

Agenda (Attachment 1)
Visitor's List (Attachment 2)

* These minutes were completed after the interim recessed and were not approved by the subcommittee.

COMMITTEE ACTION

- ▶ Agreed the EQC should be made award of the three reference publications completed by the Energy Policy Subcommittee.
- ▶ Approved a motion to define the term construction in the ethanol incentive program.

CALL TO ORDER AND ROLL CALL

The meeting was called to order by Chairman McGee and the secretary took the roll (Attachment 3).

UPDATE ON ENERGY AND TELECOMMUNICATIONS INTERIM COMMITTEE (ETIC)

Mr. Everts noted that the ETIC met on Thursday and Friday of last week. Since he is the attorney for that committee, he acted as lead staff in the absence of Ms. Mary Vandenbosch. The ETIC did a variety of things. Mr. Gary Drook, CEO of NorthWestern Energy, updated the committee on the bankruptcy process. Mr. Drook advised the ETIC that the company expected to be out of bankruptcy by late October or the first part of November.

Mr. Everts then described the legislation the ETIC proposed for the 2005 Legislature. The first was a ring fencing bill that insulates a public utility from affiliate transactions that may impact the financial integrity of the utility. The next was a bill that provides the Public Service Commission (PSC) with the authority to review significant transactions of public utilities, i.e., asset or stock transfers. This bill establishes a 25% threshold to trigger PSC review.

The ETIC also extensively discussed a bill on the Universal Systems Benefit (USB) program. The highlights of this legislation include extending the USB program until 2009; inserting a cost effectiveness definition for renewable resources; and altering the reporting requirements related to USB activities for the Department of Environmental Quality, the Department of Health and Human Services and the Department of Revenue. Mr. Everts said he will be working on the legislation and it will be soon be available for the subcommittee to review. Mr. Everts stated that the ETIC also recommended the legislation discussed at the last Energy Policy Subcommittee meeting that consolidates energy activities within the ETIC itself.

Mr. Ebzery remarked that he believed an amendment was offered on the asset transfer bill that changed the threshold to 15% or \$500,000, whichever is greater, rather than 25%.

Mr. Everts agreed that Mr. Ebzery was correct.

Sen. Toole asked if the PSC review included approval, or if it was just a review of the asset transfer. Mr. Everts clarified that it meant approval.

Sen. Toole said he wasn't sure if this came up at the meeting, but Rep. Gallik had mentioned a discussion regarding default supply—NorthWestern Energy not wanting the responsibility and Pacific Power and Light (PP&L) having some potential interest in the issue. He asked if Mr. Everts could explain that.

Mr. Everts said this topic came up in the context of a question about NorthWestern Energy's bankruptcy presentation. It was clear from the NorthWestern executives that they would like to transfer the default supply burden, as they see it, to another entity. In the same token, they also realized it was their responsibility under law. Rep. Gallik's question was whether a transfer of that responsibility to PP&L would require a statutory change. And the answer is, it would.

Sen. Toole asked if PP&L said they wanted the default supply? Mr. Everts said they were in the room, but didn't stand up and answer yes.

Sen. Toole changed to another topic and asked what the cost-effectiveness test ended up being. Mr. Everts said his recollection is the definition was limited to off-grid renewables, but he would supply a more complete definition later.

Sen. Toole said he had read in the paper that there was a 30% gas rate increase predicted for this winter. He wondered if Mr. Drook talked about that, and if it was simply based on gas markets. Mr. Everts answered that it was.

ALCOHOL PRODUCTION INCENTIVE PROCESS

Mr. Jim Curry, Deputy Director for the Montana Department of Transportation (DOT), said he would like to have Mr. Bob Turner from the DOT, Fuel Tax Bureau, talk about what a company must do to be eligible for the fuel tax incentive. Then he would talk about how that incentive is projected to affect the state special revenue fund over the next few years.

Mr. Turner, Chief, DOT, Fuel Tax Management Analysis Bureau, said he would discuss the bureau's process in allocating money for the alcohol tax incentive program. He noted that the statutory authority for the program is codified under 15-70-501, MCA. The program requires that the state give an incentive to producers of ethanol if they build a plant in Montana and use Montana agricultural products. To receive this incentive, a company must submit to the DOT a written business plan detailing the company name and address, the location of the plant, the parties involved, the expected output and the anticipated production date. When this information is submitted, it gets the project in line for the incentive. The incentive is awarded on a first come, first-served basis.

He and his staff ask for an update on these business plans each quarter. Based on these updates, the DOT determines whether or not the facilities are meeting their goals and whether they are getting the necessary financing, etc. The information is also passed along to the DOT budget and finance staff. Once the plan comes in, the plant must meet certain milestones in order to retain its place in line and remain eligible. The first milestone is that within 24 months of submitting the business plan, the construction or reconstruction of the plant must begin. Within 36 months, 50% of the construction or reconstruction must be completed. Within 48 months, the plant must have been completed and be in production.

The program incentive states that for every gallon of alcohol produced that is 100% from Montana products, the DOT will pay 30 cents a gallon up to \$3 million per applicant with a maximum cap for the DOT of \$6 million. An applicant that produces 10 million gallons will meet the applicant cap, so the two applicants that come in first will probably meet the DOT cap. Currently the DOT has five applications.

Mr. Ebzery wanted to confirm that there were five applicants, but so far no money has been awarded. He asked if that was because a facility must actually be producing ethanol in order to get the credit. Mr. Turner said that is correct. If an applicant is third in line and producing ethanol, that applicant is not awarded money because the first two applicants that are ahead in line are entitled to a reservation of the money, as long as they are reaching the designated milestones.

Mr. Ebzery asked, if someone had a viable project and were 6th on the list, could they qualify ahead of the place holders to receive money? Mr. Turner said no, because the first two projects already have reserved the available money as long as they meet their milestones.

Mr. Ebzery asked if any plants have started construction. Mr. Turner said yes, the Hardin project. Mr. Ebzery asked if they would be in line for the first \$3 million. Mr. Turner said yes, as long as they meet their other milestones.

Mr. Ebzery inquired if there has been any other construction. Mr. Turner said the Great Falls plant has drawn plans, purchased land and hired a construction company, which the DOT determined meets the criteria of starting construction.

Mr. Ebzery remarked that even though there has been no dirt turned, they have a reservation for the first \$3 million. Mr. Turner said that is correct. He explained the difficulty is in discerning the definition of construction, since there is no definition in the law.

Mr. Ebzery questioned if he believed a clarification in law was needed? Mr. Turner answered that a definition of construction would make it easier to administer the law.

Sen. McGee asked if the \$6 million cap was for each year. Mr. Turner said it was. Sen. McGee then inquired how long the program has been in place. Mr. Turner answered he believes it has been in place since the 1980s.

Sen. McGee asked what happens to the \$6 million dollars per year not expended. Mr. Curry said that in the DOT's planning process, the department reserves what they expect to pay out for the ethanol incentive based on the business plans. If in any given year, the DOT anticipates that the \$6 million cap will be paid out, it is built into the projections that eventually evolve to the working capital balance of the state special revenue fund. If the payout doesn't occur, it simply means the actual working capital balance of the fund is that much larger. It is not transferred to any other account, it is simply a line item that the DOT plans for within the account.

Sen. McGee asked for clarification that the DOT does not exhaust the funds that are in the account on an annual basis. Mr. Curry said that is correct. The DOT puts together a long term plan on how to manage that fund so the department can plan for a long term program without the need for any fuel tax increase. In order to do that, the DOT has to maintain a working capital balance in the fund.

Sen. McGee inquired if there has been a substantial increase annually over the last 15 or 18 years from the earmarked dollars that didn't go out for ethanol production.

Mr. Curry said if the DOT just took that \$6 million a year and reserved it, that would be true. What the DOT does instead is utilize those funds for highway improvements. The DOT doesn't allow the working capital balance to build based on the ethanol reservation.

Sen. McGee questioned what balance the department tries to keep for that account. Mr. Curry said he would review the account for 2007 with the subcommittee as an illustration. Based on conservatively low revenue estimates and estimates that all appropriated dollars coming out of the fund will be spent, the DOT is anticipating a working capital balance in the fund of \$17,200,000 in 2006 and of about \$1 million in 2007. The DOT is anticipating that in state Fiscal Year (FY) 2006 the DOT will pay out \$3.3 million in ethanol incentives based on the business plans for the Hardin and Great Falls plants and then in FY 2007, they anticipate the entire \$6 million dollars will be paid out. Those amounts are built into the working capital balances that were just described to the subcommittee. If those payments do not occur, the working capital balance would increase to \$20,500,000 for FY 2006 and almost \$10,400,000 for FY 2007.

Sen. Toole asked how close the Hardin plant is to production.

Mr. Curry indicated he is anticipating expending the entire \$3 million for the Hardin plant in 2006.

Mr. Ebzery remarked that his understanding is that the plant in Hardin is also a coal fired plant producing electricity—not exclusively built for ethanol. If that's the case, is the money still released based on the plant producing ethanol?

Mr. Turner stated that the Hardin facility started out as two plants, a coal fired plant and an ethanol plant. The coal plant was split off and sold to a company from South Dakota, so the ethanol plant stands by itself. The company started construction and if they make their milestone they will be in production.

Sen. McGee thanked both Mr. Turner and Mr. Curry for their presentations and asked if there was public comment. There was none.

REVIEW OF DRAFT PUBLICATIONS

Mr. Everts began discussing the bonding pamphlet (Exhibit 1). He explained he believed this would be a timely publication. He just received a bill draft request to duplicate the Wyoming infrastructure authority and he thinks that request is the beginning of several bills that will be utilizing bonding mechanisms in the state. State Bond Counsel Mae Nan Ellingson produced the brochure based on the subcommittee's request. She defines state debt, describes bonds, describes the types of state debt and provides ratings on state bonds and current and outstanding issues. If the pamphlet doesn't reflect the subcommittee's wishes, now is a good time to discuss this. He and the author are both open to changes.

Ms. Ellingson asked via Mr. Everts that it be mentioned that each legislative session the Department of Administration publishes a 20 page pamphlet that is essentially a statistical report regarding the amount of current state debt and it was her intention to not duplicate that information.

Sen. McGee asked if the subcommittee did not give any direction in regard to this pamphlet, would it still be produced. Mr. Everts noted that it would. The three publications being discussed today were all fact-based rather than policy based and if the subcommittee has any ideas to add within the next week, he would be glad to incorporate them.

Sen. McGee questioned if these publications would go before the EQC for approval. Mr. Everts answered no, since there are no policy issues involved, unless that is the wish of the subcommittee. Sen. McGee asked Sen. McNutt [Chair of the EQC] if he thought the EQC would like to review them.

Sen. McNutt thought it would be appropriate to just make the EQC aware of the publications.

Mr. Everts went on to discuss the next two publications. He noted they were both updates of previous publications requested by the subcommittee. One is "The Electricity Law Handbook" (Exhibit 2) and the other is "Understanding Electricity in Montana" (Exhibit 3), though a more accurate description of the second publication would be understanding energy in Montana. The "Understanding Electricity" publication is a statistical booklet compiled by what is left of the energy staff at the DEQ. This year, the authors added a petroleum chapter to the existing chapters on electricity, coal, transmission and natural gas.

INSTRUCTIONS TO STAFF

Sen. McGee asked if there was any further discussion or instructions to staff.

Mr. Ebzery said the subcommittee had made a recommendation for a statutory change in the ethanol incentive program and asked Mr. Everts to review the subcommittee's recommendation and see if there is additional language needed.

Mr. Everts related that at the last meeting in July, the subcommittee presented to the EQC—and the EQC approved— LC 208. The language in LC 208 states that "an applicant may not submit more than one written plan, as required under the statute, concurrently for the same location." Which means a company may only have one application in at one time for the same production facility.

Mr. Ebzery stated that given Mr. Turner's comments about the difficulty determining what constitutes construction, he thought it might be a good idea for the subcommittee or the Council to tighten up the definition. He could not conceive when buying land could be defined as construction. If ethanol is indeed the coming fuel in Montana, and if it is a viable energy source, the subcommittee should tighten up the language to sort out the real candidates that may emerge because of a federal energy bill or tax incentives from the pretenders that tie up the incentive by buying some land. He would like to make a motion to recommend to the EQC that they revisit the definition of construction.

Sen. Toole asked if this would affect current projects. He remarked that he's struggling with the concerns he has heard from the energy industry—that it's difficult to get projects started without some market certainty—though he thinks this is mostly regarding the preapproval discussion before the PSC for the development of large plants. He agrees there should be a firm line for when a project is eligible for the incentive. But he's not sure what the financial community's response will be if an applicant presents a proposal that states—when we start construction, we will be eligible for \$3 million. He's inclined to hesitantly agree that there should be a clear line, but he's not sure defining construction is it. Someone could get a backhoe and dig a hole and say they're in line for the incentive. Preventing gaming is not always easy, as the subcommittee has seen when the DOT has two proposals for the same plant in different spots in the queue.

Sen. McGee agreed it will be difficult to define construction so that it can not be manipulated. He explained that it makes more sense to him that the incentive state that a company will receive the money when they start producing, and remove all the milestones in between. He believed that would make the process more competitive. He's not arguing against the motion, but it will be difficult to come up with something fool proof.

Mr. Ebzery remarked that he and Sen. McGee are arguing different issues. He said if his motion passes and the senator wants to make a substitute motion, he would probably support that, but he doesn't want to lose the opportunity to resolve this problem. He agrees with Sen. McGee that the company should be producing to get the incentive money.

Mr. Everts noted he would be glad to work on a definition, but he was curious if the DOT legal staff has already done so. Mr. Curry said the DOT has not, but would also be happy to work on a definition.

Sen. McGee said the motion on the table was to define construction in regards to the ethanol incentive program. Sen. Toole clarified that they were directing Mr. Everts and the DOT to draft a definition of construction. Sen. McGee confirmed that was correct.

Sen. McGee asked for a vote on the motion. The motion carried.

Sen. McGee asked Sen. McNutt if he believed this issue should be further discussed with the EQC. Sen. McNutt suggested that Sen. McGee recommend in his subcommittee report that the EQC review this topic when Mr. Everts and the DOT have more information to offer.

Sen. Toole said, in preparation for that discussion, he would like to know more about how big a problem the lack of definition has been. He referred the question to Mr. Curry. Has having projects in line where no spade has been turned had the effect of keeping other companies from applying?

Sen. McGee added, as he understood it, there were six applications, and only two have a chance of receiving money. If the first two that come in are meeting their milestones, the other four have no chance of receiving money unless one of the first two applicants happen to withdraw.

Mr. Curry said that is accurate. What he might add is that of the six applications on file right now with the DOT, four are from the same applicants. The Hardin plant filed first, then the Great Falls plant. Then the Hardin plant filed again. There's nothing to prevent that. So what the company did was file a placeholder in case they didn't meet the first milestones. In regard to Sen. Toole's question, this is the major issue he is aware of. What the companies are doing is allowable in law. Whether it was the Legislature's intention is another question.

Sen. Toole remarked that the subcommittee should be cautious about finding a solution for a nonexistent problem. His impression is that there are two separate viable entities both progressing. For future public policy purposes it makes sense to define construction, but he doesn't see the lack of definition as a burning problem.

Mr. Curry said that's probably true. Probably the biggest question is what does the DOT define as construction in situations like the Great Falls project.

Sen. Toole asked, if the second company loses its place in line, does the reservation drop to another Hardin proposal? Are projects one and three the same plant? Mr. Curry said that is correct.

Sen. McGee asked who were the fifth and sixth applicants. Mr. Curry said he didn't have that information with him. Sen. McGee asked if they were duplicates of the first two applicants. Mr. Curry said one is Great Falls but Hardin is not one of the fifth or sixth applicants.

Sen. McGee asked for clarification that whatever applicant in the queue is neither the Great Falls nor the Hardin plant is then precluded from the incentive money. Mr. Curry agreed that was correct.

Sen. McGee wondered whether submitting a business plan is the best trigger for eligibility for the money. Would it reduce the game playing and move projects forward more quickly if the person who first produces ethanol is first in line for the incentive money?

Mr. Curry said it would certainly simplify the process and make it more competitive. He said he doesn't want to speak for the industry, but what he remembers hearing in testimony over the years is that the companies that are building these plants require the ability to say they are in line for the incentive as an integral part of being able to get a financing package to build the plants.

Mr. Ebzery remarked that there's a candidate running for Governor who says there could be 11 ethanol plants along the Hiline. If the federal energy bill passes there will be a big ethanol tax credit created by the federal government that may be big enough so that the state may eliminate their incentive and free up the money for road construction. If that occurs, the state should be ready because if there are opportunities there they should not be in the hands of people who remain standing on third base. He recommends that they take some action.

PUBLIC COMMENT

There was no public comment offered.

ADJOURN

There being no further business, the meeting adjourned.